The three most significant costs in providing payphone service are LEC line charges, premises owner commissions, and field service and collection costs -- the same costs that any PSP will face. Non-LEC PSPs have traditionally had only one source of interconnection to the public switched telephone network -- the LECs -- and, therefore, have little negotiating leverage to reduce these costs. Moreover, PSPs, in order to remain competitive with the LECs and their payphone services, must attempt to pay commissions to premises owners at a competitive level with what the LECs pay. As a result, the only costs that Peoples directly controls are field service and collection costs. These are the costs to maintain its 38,000 "smart" payphones and which require substantial field operations to ensure that these advanced payphones are able to provide the highest quality service to consumers. These three direct elements comprise over 64 percent of Peoples' expenses to originate a completed local, 0+, or dial-around call. As Table 3 illustrates, Peoples' average pre-tax cost per call is $0.40.

In addition to having a per call compensation mechanism that covers expenses, traditional rate of return regulation allows companies to earn a reasonable return "on the value of the property which it employs for the convenience of the public equal to that generally being made . . . in other business undertakings which are attended by corresponding risks and uncertainties."[24] In order for Peoples to earn a reasonable rate of return of, for example, 10 percent, monthly costs on a per phone basis increase by approximately $28.00 or by $0.06 per call. As a result, it costs Peoples $0.46 to originate each call, whether it is a local, access

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[24] *In the Matter of American Telephone & Telegraph Co. and the Associated Bell Companies Charges for Interstate and Foreign Communications Service*, Interim Report and Order, 9 FCC 2d 30, 60-61 (1967).

code, 800 subscriber or 0+ call, and still be able to provide a reasonable return to its shareholders.

To further buttress the underlying bases for at least a $0.45 per call SAFE charge, Table 4 examines Peoples' pro forma Net Income under six different per call compensation scenarios. The objective of this analysis is to determine the effect of various compensation plans on Peoples' operations. Three elements in the analysis change under each scenario. First, gross revenues on a per phone basis vary depending upon the per call compensation (for either local calls or "dial-around" calls) considered. Second, the components of Peoples' direct costs remain constant except for premises owner commission expenses, which vary based on the per call compensation received. Other costs, including overhead, depreciation and interest expense remain constant -- assuming no increase in the number of operational payphones. Third, income taxes are reflected at Peoples' effective tax rate based on pre-tax net income under each scenario. Return on assets is calculated by dividing company net income by Peoples' payphone net depreciated asset base of approximately $129 million (see Table 3 above).

Table 4 -- Effects of Various Per Call Compensation Rates*

		Same Local	**Same Local**	**$0.35 Local**	**$0.40 Local**	**$0.45 Local**	**$0.50 Local**
Cost Category	**Actuals**	**$0.35 DAR**	**$1.12 DAR**	**$0.35 DAR**	**$0.40 DAR**	**$0.45 DAR**	**$0.50 DAR**
Gross Revenue	237.74	256.18	336.32	296.18	327.93	359.67	391.42
Direct Costs	177.10	181.99	203.23	192.59	201.00	209.42	217.83
Gross Margin	60.64	74.19	133.09	103.59	126.93	150.25	173.59
Overhead	26.90	26.90	26.90	26.90	26.90	26.90	26.90
Operating Income	33.74	47.29	106.19	76.69	100.03	123.35	146.69
Depr, Int, Taxes	61.06	61.06	77.99	66.92	75.67	84.42	93.17
Net Income	($27.32)	($13.77)	$28.20	$9.77	$24.36	$38.93	$53.52
Return on Assets	**-16.77%**	**-4.95%**	**10.13%**	**3.61%**	**8.75%**	**13.99%**	**19.23%**

* "Same Local" means that local coin rates remain at current levels; "DAR" is dial-around compensation.

The first scenario illustrates the impact of a $0.35 per call dial-around compensation amount (0+, access code, and 800 subscriber calls), leaving the current local coin rates in effect. Under this scenario, Peoples continues to show a loss on a per payphone basis of approximately $14 per payphone. Indeed, it would take a dial-around rate of $1.12 per call for Peoples to earn a reasonable 10 percent rate of return, if the current local coin rates are left in effect, as the second scenario demonstrates. Again, this is because local calls comprise at least 70 percent of the calls originating from a typical Peoples' payphone.

The remaining four scenarios examine the impact of increasing dial-around and local coin rates. If dial-around compensation and local coin rates are both set at $0.35 per call (scenario 3), Peoples would earn only a 3.61 percent return on its payphone-related assets. Only when local coin rates and dial around compensation are set at $0.45 does Peoples earn a reasonable rate of return of approximately 14 percent. Even with both local coin rates and dial-around compensation set at $0.50 each, Peoples would still earn less than a 20 percent rate of return -- certainly not an unreasonable rate of return given the risks attendant to the competitive payphone business.

E. Interexchange Carriers (Both Intra- and Interstate Carriers) Should Continue to be Required to Pay Compensation.

The Commission has correctly concluded that either a "carrier-pays" or a "set-use fee" system would satisfy Section 276's requirements for a per call compensation plan.[25] Both types of systems would satisfy Section 276's mandate to fairly compensate PSPs. Peoples supports the Commission's conclusion that it is in the public interest to favor

[25] *Notice* at ¶ 28.

approaches that minimize transaction costs on the caller and on the industry. In light of this, Peoples supports the Commission's tentative conclusion that a "carrier-pays" mechanism would result in fewer transaction costs, because OSPs could aggregate and streamline their payments to payphone providers.[26]

A carrier-pays approach could be modified to work with a SAFE charge, by requiring that the OSPs pay PSPs the SAFE charge. It would be within the OSP's discretion how to recover its SAFE charge expenses. This mechanism would build on existing compensation procedures and would be the least costly to implement.

F. Ability of carriers to track calls from payphones.

Peoples supports the Commission's tentative conclusion that tracking mechanisms, through the use of the ANI, exist to support the completed per-call compensation plan mandated by the Section 276 (that is, requiring all IXCs that carry access codes calls and toll-free calls originated from payphones to track payphone calls).[27] In the alternative, if the Commission decides to use proxies, the data presented in Tables 1 and 2 above provide information on a typical Peoples' payphone call profile, upon which the Commission could base such proxies for determining the number of each type of call a PSP's payphone originates each month. This data could be used to develop a flat-rate, per payphone compensation system, similar to the carrier access code flat-rate mechanism currently in use.

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26 *Id.*

27 *Id.* at ¶ 30.

G. Administration of a per-call compensation scheme.

Peoples supports the use of the current direct-billing arrangement with the simple addition of requiring all facilities-based OSPs, and the intrastate interexchange operations of LECs, to send back to each PSP a statement indicating the number of 800 subscriber and access code calls that each carrier has received from each of that PSP's payphones. This should be accomplished on a monthly basis so that compensation can be remitted timely.

The Commission should leave the remainder of the billing arrangements to the parties; however, Peoples suggests that remittance of billings should be done on a monthly basis, rather than on the quarterly basis now in place. The Commission also should impose minimum regulatory guidelines to resolve disputed ANIs in the per-call compensation context. Peoples supports the minimum guidelines in the Notice.[28] Peoples suggests, however, that interest be included on any unpaid disputed SAFE charges later found to be justified.

V. CONCLUSION

Congress has provided the Commission with the authority to craft a comprehensive payphone compensation plan that fairly compensates PSPs for each and every completed call that originates from their payphones. To accomplish this in the most efficient and equitable manner, the Commission should adopt a nationwide SAFE of at least $0.45 per call. This rate should apply as a cap for local coin calls, as well as a set rate for non-coin call, including all access code methodologies. For non-coin calls, the SAFE charge should be paid by the carrier and remitted to the PSP monthly. A rate of $0.45 per call will provide PSPs

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28 *Id.* at ¶ 34.

with compensation to cover their payphone origination costs as well as provide PSPs with a reasonable rate of return on their payphone investment dedicated to the public use.

In the interim, the Commission must immediately adopt a flat-rate, interim compensation plan to compensate PSPs for "the growing number of dial-around calls" that originate from their payphones and for which PSPs currently receive little or no compensation. A typical Peoples' payphone, for the six-month period ending in April, 1996, originated an average of 86 800 subscriber calls per month. With the cost of providing these calls approximately $0.45 per call, Peoples is losing approximately $38.70 per payphone per month, or with its 38,000 payphones nationwide, almost $1.5 million per month. In addition, the Commission should increase the flat-rate amount used to compensate PSPs for access code calls from $6.00 to $19.35 per payphone per month and increase the per call charge from $0.25 to $0.45 accordingly. Only with a comprehensive system for fair compensation will the competitive payphone industry truly thrive as envisioned by the 1996 Act.

Respectively submitted,
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July 1, 1996

<u>CERTIFICATE OF SERVICE</u>

I Benita P. Bailey hereby certify that I have this 1st day of July, 1996 caused copies of the foregoing "Comments of Peoples Telephone Company, Inc." to be served by hand on the following:

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